

Opinion
No. 1251

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SUPERIOR COURT OF THE DISTRICT OF COLUMBIA
Tax Division

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DISTRICT OF COLUMBIA
DIVISION

AUG 5 1983

SQUARE 254 LIMITED PARTNERSHIP, :
et al. :

Petitioners, :

v. :

DISTRICT OF COLUMBIA :

Respondent. :

Tax Docket No. 3256-83

FILED

ORDER

This matter came before the Court for trial. Square 254 Limited Partnership and the Pennsylvania Avenue Development Corporation (PADC), lessees and lessors, respectively, of Square 254, Lot 032, challenged the Tax Year 1983 assessment of their property. Upon consideration of the arguments of counsel and the record herein, the Court makes the following:

FINDINGS OF FACT

1. The subject property is Lot 032 in Square 254 in the District of Columbia with premises known as 1325 Pennsylvania Avenue, N.W.
2. Petitioner Square 254 Limited Partnership, Quadrangle Development Corporation, General Partner (hereinafter "Square 254") is the lessee of the subject property and the owner of the improvements thereon. By the terms of the land lease agreement petitioner is obligated to pay all real estate taxes assessed against the subject property.
3. Petitioner Pennsylvania Avenue Development Corporation (hereinafter "PADC") is the owner of record of the subject property and under the terms of the land lease agreement joins in the Petition as a named petitioner.

4. The Respondent, District of Columbia, is a municipal corporation, created by the United States Congress, Section 1-101 of the District of Columbia Code.

5. In March of 1982, Petitioner Square 254 received a notice of annual assessment dated March 16, 1982, stating that the assessment on the subject property for Tax Year 1983 was \$56,952,000.

6. The appeal to the Board of Equalization and Review in Petition No. 83-1970 was timely filed on April 14, 1982. Oral hearing was held before the Board of Equalization and Review. By decision dated June 1, 1982, the Board informed Petitioners of its decision to reduce the assessment to \$47,000.00.

7. The taxes and assessment in controversy are real estate taxes and assessment for Tax Year 1983 in the following amounts:

Total Assessment:	\$47,000,000
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Total Taxes:	\$ 1,001,100
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8. The Tax Year 1983 taxes in the amount of \$1,001,100 have been paid in full. First-half taxes in the amount of \$500,550 were timely paid on September 15, 1982. Second-half taxes in the amount of \$500,550 were timely paid on March 31, 1983. The actual amount of second-half taxes paid was \$661,657 due to a second-half assessment allegedly made pursuant to D.C. Code §47-830 (1981 ed.); at the time of the filing of the stipulations in this case, appeal of the second-half assessment was before the District of Columbia Court of Appeals.

9. The subject property contains a total land area of 120,723 square feet and is zoned C-5-PADC, permitting new construction. As of January 1, 1982, the valuation date for

Tax Year 1983, the subject property as an excavated site plus the existing National Theatre building.

The subject property was subject to limitations imposed by the Pennsylvania Avenue Development Corporation on the development of the subject property. One limitation was that the National Theatre building could not be razed, but rather had to be renovated and that nothing could be built above the National Theatre building. The second limitation was that a certain portion of the subject property had to be devoted to hotel use. In this case, the new construction would contain 533,854 square feet of hotel floor area ratio along E Street, N.W., (with Pennsylvania Avenue exposure) and 483,743 square feet of office space along F Street, N.W. Retail uses are permitted along F Street, N.W.

10. The highest and best use of the subject property, as of January 1, 1982, was for development under the Pennsylvania Avenue Development Corporation requirements.

11. Petitioners offered expert testimony and a written report setting forth the estimated market value of the subject property as of January 1, 1982, the valuation date for Tax Year 1983. Petitioners' expert witness testified to and set forth in his written report an opinion of value of \$30,326,000 with an allocation of \$29,829,000 to land and \$497,000 to improvements.

12. The Respondent District of Columbia did not offer expert testimony or evidence.

13. The Petitioners' expert witness was Anthony Reynolds, M.A.I. Respondent District of Columbia stipulated to Mr. Reynolds' qualifications as an expert witness and Mr. Reynolds' written report was admitted into evidence at trial. The Petitioners' expert used the comparable sales approach to value the subject property.

14. The subject property is unique in its limitations as a result of its zoning and ownership, subject to PADC restrictions. Petitioners' expert therefore stated that the floor area of building that may be developed on the subject property and the uses to which the various segments of floor area could be put was of great import. Mr. Reynolds calculated the permitted floor areas as:

<u>Use</u>	<u>Area</u>
Hotel	533,054 sq. ft.
Office	403,743 sq. ft.
Theatre	<u>48,627 sq. ft.</u>
Total	1,066,294 sq. ft.
Less Theatre	<u>48,627 sq. ft.</u>
Developable	1,017,597 sq. ft.

The gross square feet of floor area, 1,066,294 square feet, divided by the entire land area, 120,723 square feet, yields an FAR of 8.83. But the effective or economic FAR computation is derived by dividing the developable floor area of 1,017,597 by the effective lot area of 100,910 square feet, which yields an FAR of 10.00. The subject property, in addition to the theatre building, is effectively two massive sites, one for office use and the other for hotel use. Mr. Reynolds testified that the subject property is disadvantageous in its size and development configuration.

15. The subject property, except for the portion on which the National Theatre building was situated, was considered to be exclusively land as of the valuation date, although excavation on the site had begun. Petitioners' expert used the comparable sales approach to value the subject property, which is the preferred valuation method for property consisting of vacant land. Although vacant, the subject property is considered with its legally possible

rights. A purchaser of the subject property would have to comply with certain restrictions. Mr. Reynolds stated that the income capitalization method was too speculative to value such a property and the comparable sales method was the method used by actual buyers and sellers in the marketplace for such land.

16. Mr. Reynolds testified that he used comparable sales of land to determine the land value of the subject property. The elements of comparison were location, permitted use, date and physical differences such as size. Mr. Reynolds' unit of comparison was square-foot-of FAR, which he testified was more appropriate for the subject property than price per square foot of land. Mr. Reynolds testified that, using the comparable sales set forth in his report, he concluded that a typical site in the immediate neighborhood of the subject property had a value on January 1, 1982 of \$50.00 per square foot of FAR. He then reduced this \$50.00 per square foot of FAR market standard ten percent to \$45.00 per square foot of FAR in recognition of the disadvantageous configuration of the developable parcel and in recognition of the unusually large size of the subject property, which would normally require staged construction.

17. Mr. Reynolds testified that, for use of the subject property as office space, the value of the subject property per square foot of FAR would be \$45.00. However, the property is limited in its development in that the entire square footage of the subject property could not be devoted to use as office space. As a result of the PADC restrictions on the subject property, only 483,743 square feet had to be devoted to the less remunerative hotel use and 48,697 square feet had to be devoted to the National Theatre building.

18. Mr. Reynolds testified that it was his expert opinion that the hotel component of the subject property would have a value one-half of that for the office space. Petitioners' expert gave examples of negotiations in which use of the subject property would be contemplated as a hotel and consequently, in which the price which a willing buyer would pay a willing seller would be reduced in proportion to the economic gain which could conceivably be realized from use as a hotel. Mr. Reynolds discussed sales of land zoned C-2 and certain SP zones in which hotel use for part or all of the property is mandated by zoning. Mr. Reynolds also testified as to a specific sale with which he was familiar where the portion of the property purchased for a hotel was valued at \$50 per square foot of FAR and the portion purchased for development as an office building as valued at \$100 per square foot of FAR. Mr. Reynolds testified that buyers and sellers negotiating and concluding sales of real property in the District of Columbia view property which may only be developed as a hotel as being valued at approximately one-half of the value of property being purchased for development as an office building.

19. Mr. Reynolds also testified as to his opinion of the value of the portion of the subject property on which the National Theatre building is located. This portion of the subject property contained 19,813 square feet of land and the theatre building contained 48,697 square feet of FAR. Under the restrictions placed on the subject property, the theatre building could not be razed, nor could anything be built in the envelope above the building. In addition, five to six

million dollars had to be expended to renovate the theatre building, thus creating what Mr. Reynolds characterized as a "lien-like" requirement on the theatre portion of the subject property in the amount of five to six million dollars minus the investment tax credits of approximately twenty percent. As of the valuation date, January 1, 1982, the National Theatre building had only begun to be renovated and \$497,000 had been expended in renovations. Mr. Reynolds therefore valued the improvements at \$497,000. He also testified that the theatre use to which this portion of the property was restricted had no economic worth. Thus, Mr. Reynolds valued the land component of the subject property restricted to this use at a nominal value of \$1 per square foot of FAR.

20. Mr. Jerry Smedley, Director of Real Estate, Pennsylvania Avenue Development Corporation also testified. Mr. Smedley testified that the properties which later comprised the subject property were purchased for a total price of \$21 to \$22 million during the period 1978 to 1981. Mr. Smedley also testified that, under the terms of the restrictions on the subject property, no buyer could remove the National Theatre building and put up an office building. In addition, Mr. Smedley testified that it was mandatory that the National Theatre building be renovated and that a portion of the subject property be developed with hotel space. In negotiations of the land lease, Mr. Smedley testified that one party had valued the subject property at \$27,000,000 and the other party had valued the subject property at \$21,000,000. A compromise was eventually reached between the two values. Mr. Reynolds testified that a value in this range for the period 1979 to 1980 would comport well with his

estimate of value as of January 1, 1982 at slightly in excess of \$30,000,000.

21. Mr. Reynolds used as comparables the purchase of the lots which were later consolidated to form the subject property itself. On page 11 of his report, Mr. Reynolds set forth the acquisitions placing special emphasis on the most recent portion acquired for the consolidation, lots 22 and 49 in Square 254. These properties were purchased in November, 1981 at a price of \$4,912,108 for 28,751 square feet, or approximately \$171 per square foot. If the \$171 purchase price is divided by the attributed FAR of 10, the price per square foot of FAR becomes \$17.10.

22. In addition to the valuation performed by Mr. Reynolds, he also examined the Tax Year 1983 assessment for the subject property in light of equalization considerations. He looked at the Tax Year 1983 assessments for several other properties in the area of the subject property. Mr. Reynolds found that the assessments ranged from \$104 to \$400 per square foot, which translated, when divided by the appropriate FAR's for each piece of property, to a range of \$22.35 to \$38.00 per point of FAR. The assessment of the subject property for Tax Year 1983 was at \$471.76 per square foot and at \$47.18 per point of FAR.

23. In Mr. Reynolds' equalization analysis, Mr. Reynolds examined the assessments of several neighboring properties and compared them with each other and the recent sale prices of the properties. He concluded that the subject property was not in equalization with other similarly situated properties.

24. Petitioners also called Mr. Paul Spruill, the assessor charged with assessing the subject property for Tax

Year 1983 to the stand. Mr. Spruill testified that he had assessed the subject property for Tax Year 1983. However, Mr. Spruill produced no physical evidence in support of his assessment. The assessor attempted to apply the comparable sales method in valuing the subject property for tax assessment purposes for Tax Year 1983. However, few of the sales used were, in fact, comparable. None of the sales was for property located on Pennsylvania Avenue. The assessor also used incorrect FAR's for sale properties and did not consider relevant factors influencing the sale prices, including PADC requirements.

25. The assessor stated that he made no adjustments to his comparables for the size of the subject property or for the configuration of the subject property. Although Mr. Spruill testified that he knew of the developmental limitations on the subject property (which included the necessity that a hotel be built on the site and that the National Theatre building be renovated and preserved), he testified that he made no adjustments to his so-called comparables for these limitations. Moreover, Mr. Spruill could not explain the relationship of the assessment of the subject property to the values of the sales. Further, he was unable to explain whether he derived the value per square foot or the value per square foot of FAR from the so-called comparable sales and could not justify the deviation of his value for the subject property from the usual statistical measures applied to the comparable sales.

26. Respondent also called Mr. Spruill in its case in chief. Upon objections by petitioners' counsel, Mr. Spruill was limited to testifying only as to what he did to make the assessment of the subject property for Tax Year 1983 and

evidence was limited to what had been produced by respondent in response to petitioners' discovery before trial. Although the actual average of the comparable sales used by Mr. Spruill was \$45 to \$50 per square foot of FAR, Mr. Spruill's assessment of the subject property as based on a value at \$56 per square foot.

Mr. Spruill admitted, upon cross-examination by petitioners' counsel, that many of the answers he had given in testimony before the Court had not been included in his answers to interrogatories and that his answers to interrogatories were incomplete. Moreover, the assessor admitted that his trial testimony was inconsistent with his sworn testimony at deposition. He further conceded that although he had sales of C-5 land which could have been used as comparable sales for purposes of his assessment, he used C-4 sales instead.

CONCLUSIONS OF LAW

Superior Court review of a tax assessment is de novo, necessitating competent evidence to prove the matters at issue. Wynar v. District of Columbia, 411 A.2d 59 (D.C.App. 1980). The correct assessment of the subject property for Tax Year 1983 is its "estimated market value", that is, the value of benefits associated with ownership of the property. The assessment here at issue is the Tax Year 1983 assessment, as reduced by the Board of Equalization and Review, in the amount of \$47,000,000.

The Court has jurisdiction under D.C. Code, §§11-1201, 47-3303 and 47-3304 (1981 ed.). Petitioners contend that the assessment was arbitrary and excessive in violation of D.C. Code §47-801, et seq. (1981 ed.) and the due process clause of the United States Constitution. Because statutory and

factual consideration are sufficient to resolve this case in favor of petitioners, the Court need not reach the constitutional issue.

The Court finds that the assessment as made was invalid and void as a matter of law and that petitioners provided credible evidence that the value of the subject property as determined by properly applying the comparable sales approach should be \$30,326,000 for Tax Year 1983. Upon review of the testimony and documentation presented, the Court concludes that the comparable sales approach was properly performed by petitioners' expert, using sales data that has not been disputed, and making appropriate adjustments for the developmental limitations of the subject property, thereby producing an accurate estimate of market value.

Real property in the District of Columbia must be assessed at its "estimated market value." D.C. Code §47-820(a) (1981 ed.); 9 D.C.M.R. §306.1. "Estimated market value" is defined as:

100 per centum of the most probable price at which a particular piece of real property, if exposed for sale in the open market with a reasonable time for the seller to find a purchaser, would be expected to transfer under prevailing market conditions between parties who have knowledge of the uses to which the property may be put, both seeking to maximize their gains and neither being in a position to take advantage of the exigencies of the other. D.C. Code, §47-802(4) (1981 ed.) (Emphasis added).

In this case, the "uses to which the property may be put" are crucial to determining the value of the subject property.

The evidence was uncontroverted that the subject property was not property on which an office building alone could be placed. The property was governed by PADC restrictions which limited the size and the use of the improvements that could be constructed on it as of the valuation date, January 1, 1982. There were two major

restrictions on the subject property. The first restriction was that the National Theatre building had to be preserved and had to be renovated. This restriction meant not only that the square footage of land on which the National Theatre building was located could not be developed in a more lucrative manner for the taxpayer, but that the taxpayer had to pay approximately \$5 to \$6 million to renovate the building. This restriction was a major factor which was not taken into account by the assessor when making the assessment.

In addition, another restriction on the subject property was a requirement that 533,854 square feet of the total 1,017,597 square feet of non-theatre developmental FAR be consigned to a hotel use. Petitioners' expert testified to his opinion of the reduction in value which must be assigned for hotel use of 533,854 square feet of FAR. Petitioners' expert gave several examples of sales prices negotiated for hotel uses and for hotel projects previously completed on the Pennsylvania Avenue corridor. The Court finds Mr. Reynolds' testimony on the reduced value of property required to be devoted to hotel use to be more in keeping with assessment practice.

There are three methods for determining the fair market value of real property: the comparable sales approach, the replacement cost approach and the income approach. 9 D.C.M.R. 307. The assessor, Mr. Spruill, stated in his answers to interrogatories and under oath in deposition that he had used the comparable sales approach. He provided a list of the sales on which he had relied. The Court notes that many of the sales represented by respondent as being "comparable" were in fact not comparable. Although the subject property was located on Pennsylvania Avenue, none

of the assessor's comparables were located on Pennsylvania Avenue. The assessor also failed to take into consideration the disadvantageous size and configuration of the subject property, as well as the limitations of use which had been imposed upon the subject property.

In addition, the assessor's use of the comparable sales method did not comply with the regulations governing the use of that method. Under these regulations, the assessor was required to use sales of "reasonably similar properties" and to compare them by "property type." 9 D.C.M.R. §307.3. The assessor did not use "reasonably comparable properties" as shown by petitioners' experts' testimony. Nor did the assessor distinguish geographic developmental areas of the city or make adjustments for unique features of the sales which he did utilize. Moreover, the assessor used incorrect FAR's in applying his method.

Mr. Spruill could not adequately explain any relationship between the sale prices of the comparables used and the assessment of the subject property. He produced no documentation explaining his method and offered conflicting testimony demonstrating that he did not know how he had made the assessment of the subject property for Tax Year 1983 and that he had changed his testimony to suit the answers to interrogatories, sworn deposition testimony and testimony at trial. Moreover, there was no testimony or other evidence presented by the District that the method used by the assessor yielded the true estimated market value of the subject property.

Respondent contends that the subject property is highly visible and gives a desirable ambience to downtown Washington. The District argues that National Place is a large tourist attraction that has helped to revitalize the

area. Respondent argues, therefore, that all of these factors should be considered in assessing the property.

The Court recognizes that the subject property is clearly a unique structure. However, its uniqueness should not necessarily merit a higher assessment for Tax Year 1983. Given all of the development restrictions on the property, including the prohibition against razing or building over the National Theatre building, the Court finds that the property is not developed to its highest and best use (i.e. commercial office space). It would be premature to attribute a greater property value to the subject simply because of its uniqueness. Continued property development under the Pennsylvania Avenue Development Plan may justify an increase in the future. However, to attribute a higher value to the property for Tax Year 1983 would be too speculative.

The Court is satisfied that the assessment was arbitrary, capricious and improper. Therefore the assessment of the subject property for Tax Year 1983 was invalid and void, and the value of the subject property should be reduced to the fair market value as evidenced by petitioners' evidence at trial.

Petitioner's expert properly applied the comparable sales method to the subject property to determine its estimated market value as of January 1, 1982. The sales examined by petitioners' expert and set forth in his written report entered into evidence at trial, established that Mr. Reynolds examined comparable sales and made appropriate adjustments for location and other factors. Mr. Reynolds' value of the subject property for Tax Year 1983 was the value that a willing buyer would pay a willing seller as of January 1, 1982, both parties knowing the restrictions on the uses to which the subject property could be put.

Petitioners' expert testified that the comparable sales method, when properly applied yielded a \$50.00 per square foot of FAR market standard. Mr. Reynolds then reduced this standard by ten percent in recognition of the disadvantageous configuration of the subject property and of its unusually large size, which would normally require staged construction. Thus, Mr. Reynolds arrived at an FAR value of the office component of the subject property of \$45.00 per square foot.

For the portion of the subject property on which the National Theatre building is located, Mr. Reynolds determined that the improvements, which then consisted of the unrenovated National Theatre building enhanced by \$497,000 of renovation which had been expended as of the valuation date, and requiring at least ten times that ultimately, should be valued at \$497,000. The National Theatre building could not be razed nor could any development take place in the envelope above the theatre building. Mr. Reynolds therefore attributed to the land on which the theatre building was located a value of \$1.00 per square foot of FAR, or \$48,697.

Finally, Mr. Reynolds considered the value of the square feet of FAR mandated to be hotel. Mr. Reynolds testified to several sales and developments of hotels, noting especially those required by PADC on Pennsylvania Avenue itself and those required by certain zoning designations, e.g. certain C-2 and SP zones where hotel use is mandatory for at least a part of the property. Based upon this evidence, the Court finds that the hotel portion of the square feet of FAR was properly valued at one-half of the value for the office portion of the subject property.

In addition, Mr. Reynolds properly considered the requirement that additional funds be expended in the renovation of the National Theatre building as a cash payment

lien-like requirement of \$5,000,000 reduces by the investment tax credit of approximately twenty percent to \$4,000,000.

Mr. Reynolds properly concluded that the value of the subject land should be calculated as follows:

Hotel FAR	533,054	at \$22.50	=	\$12,011,715
Office FAR	483,743	at \$45.00	=	21,768,435
Theatre FAR	48,697	at \$ 1.00	=	48,697
Total				<u>\$33,829,847</u>
Less Net Theatre Donation				<u>4,000,000</u>
Land Value (rounded)				<u>\$29,829,000</u>


Mr. Reynolds then added the value of the unrenovated National Theatre building of \$497,000 to the land value of \$29,829,000 to arrive at his determination of the total value of the subject property as of January 1, 1982 of \$30,326,000.

The Court finds that the estimated market value of the subject property as of January 1, 1982 is \$30,326,000 of which \$29,829,000 is allocated to the land and \$497,000 is allocated to the improvements.

WHEREFORE, it is this 4th day of August, 1986,

ORDERED, that the Respondent District of Columbia shall modify the assessment record card to reflect the value of \$30,326,000 for Tax Year 1983, of which \$29,829,000 shall be allocated to the land and \$497,000 shall be allocated to the improvements, and shall refund to petitioners, with interest, the excess taxes which have been unlawfully collected for Tax Year 1983; and it is

FURTHER ORDERED, that the petitioners present a proposed order for refund, with interest, no later than ten days from the date this order is signed.


JUDGE THOMAS G. THOMAS

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